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THE STOCKHOLDERS' RIGHT TO INSPECT CORPORATE BOOKS AND RECORDS IN CASES OF RECEIVERSHIP AND REORGANIZATION

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I. RIGHT OF STOCKHOLDERS TO INSPECT CORPORATE BOOKS AND RECORDS: IN GENERAL

In England the view of the courts under the common law was that the stockholders of a corporation had the right to inspect the corporate books and records only when there was a specific dispute about some corporate matter between the stockholder and the management.[1] This view has now been modified to some extent by the English Companies Act of 1929.[2]

In this country at common law a stockholder of a private corporation has the right to inspect any or all of the books and records of the corporation of which he is a member.[3] This right, however, is subject to the qualification that inspection must be sought in good faith and for proper purposes.[4] As to what constitutes a proper purpose entitling the stockholder to inspection the courts are not in complete uniformity.[5]

The common law rule has been modified in most of the states by statutes, the majority of which imposes no express conditions upon the stockholder's right of inspection.[6] The

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[1] Rex v. Merchant Tailor's Company, 2 B. & Ad. 116 (K. B. 1831).

[2] See Companies Act, 1929, §§ 98, 121, 135, 137.

[3] Guthrie v. Harkness, 199 U. S. 148, 26 Sup. Ct. 4, 50 L. Ed. 130 (1905); Varney v. Baker, 194 Mass. 239, 80 N. E. 524 (1906); *In re* Steinway, 159 N. Y. 250, 53 N. E. 1103, 45 L. R. A. 461 (1899); Clawson v. Clayton, 33 Utah 266, 93 Pac. 729 (1908).

[4] Guthrie v. Harkness, 199 U. S. 148, 26 Sup. Ct. 4, 50 L. Ed. 130 (1905).

[5] See collection of cases in 80 A. L. R. 1502 (1932).

[6] See 5 Fletcher, Cyc. Corp. (Perm. ed. 1931) § 2220.

courts, however, have differed in their interpretation of these statutes. While some courts hold that the right is absolute where statutory, regardless of purpose, the majority of the courts regard the purposes and motives of a stockholder invoking his right of inspection under a statute as proper subjects of judicial inquiry.[7] The judicial limitation of the statutory grant, absolute on its face, is said to be justified either by the theory that these statutes are merely declaratory of the common law,[8] or because the court still retains its discretion in issuing the writ of mandamus.[9] But, whatever may be the legal theory, "the shareholder's privilege of inspecting the books and papers of his corporation should be determined by balancing his individual interest against the interests of the other members of the incorporated group with whom he is associated."[10]

The legal problems arising out of the stockholder's right of inspection while the corporation is a going concern are numerous. Their discussion, however, is beyond the scope of this paper. Here, we are interested only in the question whether the right of the inspection survives after a receiver or trustee has been appointed for the corporation.

It is well established that a receiver or trustee appointed by the court is entitled to the possession of the books and records of the corporation and that mandamus will lie for their surrender by the officers of the corporation.[11] Once the receiver or trustee has obtained possession of the books and records, the question arises whether the stockholder's right of inspection still exists. The problem has come before the courts at several instances and the purpose of this paper will be to show the judicial process which has led to its solution.

II. RIGHT OF INSPECTION IN CASE OF CORPORATE LIQUIDATION

The shareholder's right to inspect the books of a corporation

[7] O'Hara v. National Biscuit Co., 69 N. J. L. 198, 54 Atl. 241 (1903); People *ex rel.* Britton v. American Press Assn., 148 App. Div. 651, 133 N. Y. Supp. 216 (1912); State *ex rel.* Weinberg v. Pacific Brewing & Malting Co., 21 Wash. 451, 58 Pac. 584 (1899).

[8] O'Hara v. National Biscuit Co., 69 N. J. L. 198, 54 Atl. 241 (1903).

[9] Bernert v. Multnomah Lumber & Box Co., 119 Ore. 44, 247 Pac. 155 (1926); State *ex rel.* Weinberg v. Pacific Brewing & Malting Co., 21 Wash. 451, 58 Pac. 584 (1899).

[10] Stevens, Corporations (1936) 430.

[11] Manning v. Mercantile Securities Co., 242 Ill. 584, 90 N. E. 238 (1909), affd. 217 U. S. 597, 30 Sup. Ct. 696, 54 L. Ed. 896 (1910); Foster v. Stewart, 113 Kan. 402, 214 Pac. 429 (1923).

which was to be liquidated has been discussed in several English decisions.

The first case of this kind is *In re Birmingham Banking Company.*[12] In this case the shareholder of a company which was in the process of liquidation petitioned the court for leave to inspect the corporate books and records. The liquidator who opposed this petition referred to the great inconvenience which would ensue if anybody were allowed to inspect the books of the company in liquidation. The court, however, granted the leave desired by the plaintiff and ordered the liquidator to produce the books and records of the company. In the opinion of the court this order was fully warranted by the Companies' Act of 1862, which left it to the discretion of the court whether or not it wished to compel such production.[13] But the court declared it to be the duty of the petitioner not divulge the information acquired and intimated that, if necessary, it would enjoin him from so doing.[14]

In the similar case of *In re Joint Stock Discount Company,*[15] the English court reached the same decision and, upon application by several shareholders of a defunct corporation, ordered the liquidator to make the books and papers of the company accessible and to permit the taking of abstracts therefrom. But, as in the *Birmingham Banking Company* case, *supra,* the court declared that it would enjoin any disclosure of the information obtained by the shareholders.

In *In re West Devon Great Consols Mine,*[16] there was an appeal from the decree of a lower court in a winding-up proceeding authorizing the shareholders of the company which was to be wound up to examine the corporate book and vouchers. The Chancery Division considered the decree to be lawful and dismissed the appeal by a unanimous decision. Particularly,

[12] 36 L. J. Ch. 150 (1866).

[13] See Companies' Act, 1862, Sec. 156. It is interesting to note that the court granted the leave to inspect the books of the company, although there was a secrecy clause in the articles to the effect that no shareholder or creditor should have the right to inspect the books of the company.

[14] Also, in this country, the courts have held that shareholders may be enjoined from making wrongful use of the information acquired as a result of inspection. State *ex rel.* Dempsey v. Werra Aluminum Foundry Co., 173 Wis. 651, 182 N. W. 354 (1921); State *ex rel.* Mandelker v. Mandelker, 197 Wis. 518, 222 N. W. 786 (1929).

[15] 36 L. J. Ch. 150 (1866).

[16] 27 Ch. D. 106 (1884).

Lord Cotton pointed out that it was within the lawful discretion of the court below to make the order complained of:

"I do not encourage the idea that a petitioner for a winding-up order has a right to have discovery to support his case, to fish out, in fact, something that may help him. . . . The suggestion that the statements in the petition might be proved by the books would not be sufficient grounds. These were the letter and statements of the purser, and the Petitioner had a reasonable ground for asking for inspection to see if these statements and letter were well founded. I think, therefore, there were sufficient grounds for the order of inspection, and that, independently of the winding-up petition, the Vice-Warden had full jurisdiction to make it."[17]

In the United States the first case dealing with our problem is *Re Tiebout*.[18] In this case, the New York Supreme Court, on appeal, reversed an order of the lower court denying the application of a corporate creditor for leave to inspect the books

[17] 27 Ch. D. 106, 109 (1884). See also Fenton Textile Assn., Ltd. v. Lodge, [1928] 1 K. B. 1 (A receiver named by holders of a company's debenture, who had previously been the company's managing director, was held not entitled to refuse to produce its books of account and records, so far as material, to permit their inspection by a litigant claiming that a fraudulent conspiracy existed between him and the company, both being sued as co-defendants).

[18] 19 N. Y. Weekly Dig. 570 (1884). Prior to this case the New York Supreme Court had to consider the question whether a shareholder in an insolvent corporation has the right to examine the books of the receiver. In Fowler's Petition, 9 Abbot's New Cases 268 (1878), a shareholder of the Erie Railway Company petitioned the court for leave to examine the books of the receiver who had been appointed for the company. The court granted the petition, using the following language: "The receiver is an officer of the court, and the books, contracts, and accounts relating to his connection with the road are in *custodia legis*—in the custody of the law; and, therefore, in this court to all intents and purposes. He is the trustee of all the owners of the bonds and stocks, and of the creditors of the company, and these owners are his *cestuis que trust*. What he does should be done openly, unless the interests of the estate with which he is invested demand privacy, a circumstance which must rarely occur. His management is therefore for the *cestuis que trust*, who are bondholders, stockholders and creditors, and they are entitled to an inspection of his books, papers and accounts relating to his receivership, and it should be allowed on all reasonable applications for the purpose." (*Id.* 269.) But the court carefully limited its order to a leave to inspect the books of the receiver as distinguished from the books of the company itself. "It follows necessarily, therefore, that the petition presented herein, if it rests upon proper considerations, should be granted so far as it relates to the books, accounts, and contracts of the receiver, as contradistinguished from those of the company prior to his appointment, unless some good reason exists why that liberty should not be given. The petition herein presented is considered sufficient for that purpose, and no good reason is shown why it should not be granted. If the books of the company *eo nomine*, aside from those containing the transactions of the receiver, are to be inspected, it must be accomplished in some other mode not necessary now to be considered." (*Id.* 270.)

of a company in the hands of a receiver. Although the case came up on the application of a corporate creditor, the language used by the court is sufficiently broad to indicate that the decision would not have been different if the application had been made by a shareholder instead of by a creditor. The decision is interesting because, in the opinion of the court, the right to inspect the books of a company in the hands of a receiver rests on principles different from those which governed while the corporation was a going concern. Thus, it was held by the court:

"That the authority of the Court in such a case does not rest upon the technical rights of stockholders or creditors, as between themselves and the corporation, under the statutes relating to corporations, but upon grounds of justice and equity in administering the trust in the hands of the receiver, and that the application was addressed to the sound discretion of the Court in the exercise of its power over the books and papers of a corporation in the hands of its receiver and therefore in law in the hands of the Court, and that the application depends upon very different principles from those which would prevail if the books were in the hands of the company. That the matter therefore was one for the exercise of discretion, and that it was neither judicious nor equitable to refuse to any party in interest an opportunity to examine and take extracts from books held by a receiver under such circumstances."[19]

The next case involving the right to inspect the books of a corporation in the hands of a receiver is *People* v. *Cataract Bank*.[20] In this case, stockholders of a dissolved bank for which a receiver had been appointed petitioned the court for an order directing the receiver to permit them to make an inspection and examination of the books, papers, writings and property of the bank, and to make abstracts therefrom. Relying on the *Tiebout* case, *supra*, the court made the order asked for, since "no reason is apparent why the information sought by them should be withheld."

In *Matter of Tuttle* v. *Iron National Bank of Plattsburgh*,[21] the New York Court of Appeals was to consider the application by certain stockholders of a national bank, which was in the course of liquidation, for the issuance of a writ of mandamus, requiring the presentation of the books, papers and assets of the

[19] But *cf.*, also, the dissenting opinion of Judge Daniels, who held that the appellant's right of inspection could be enforced only under a special statutory provision in that regard, which could not be applied in the absence of proof that the company was incorporated under the act that contained such provision.

[20] 5 Misc. 14, 25 N. Y. Supp. 129 (1893).

[21] 170 N. Y. 9, 62 N. E. 761 (1902).

bank to the petitioners. The court affirmed the order of the Appellate Division granting the relief prayed for and the opinion pointed out that this ruling did not impede the process of liquidation.[22]

"The facts not in dispute were sufficient to justify the court in ordering the officers in charge of the bank's affairs to furnish information as to the description of the bank's assets, to the extent set forth in its order. Such information was only what the stockholders were entitled to have, in the situation of affairs. It could in no wise prejudice the liquidation of the bank, and its officers should not have refused to the stockholders the statements which they naturally desired and which, upon equitable principles, they were entitled to have concerning their distributory interests in the corporate property."[23]

The shareholders' right of inspection in case of corporate liquidation has also been discussed in some recent federal cases.

In *Wittnebel* v. *Loughman*,[24] the plaintiff was a large stockholder in a defunct national bank for which a receiver had been appointed by the Comptroller of the Currency. The receiver had taken no action against the president and officers of the bank, although the plaintiff had laid facts before him which showed mismanagement and negligence in the conduct of the affairs of the bank. When also repeated requests by the plaintiff to the receiver for permission to see the books and records of the bank had remained unsuccessful, the plaintiff brought suit to restrain the receiver from impeding his examination of the corporate books and records. The receiver moved to dismiss the suit for failure to state a cause of action claiming that the stockholders of a defunct national bank have no right to examine the books and records of the company in possession of a receiver, except by leave of the receiver and that the refusal of the receiver to permit exami-

[22] The opinion also emphasized that the rule giving to a stockholder the right to inspect the books of the corporation is as applicable to the case of a banking corporation, as it is to any other kind of corporation and that jurisdiction over actions against national banks has not been taken away from the state courts by the National Banking Act, citing Cooke v. State National Bank of Boston, 52 N. Y. 96 (1873), and Robinson v. National Bank of Newberne, 81 N. Y. 385 (1880).

[23] 170 N. Y. 9, 11 (1902). See also Commonwealth *ex rel.* v. The Phila. and Reading R. R. Co., 3 Pa. Dist. Rep. 115 (1893), where a writ of mandamus was granted to the shareholders commanding the receivers and officers of the defendant railroad company to permit them to inspect the stock ledger of list of stockholders and make copies thereof.

[24] 9 F. Supp. 465 (S. D. N. Y. 1935).

nation is conclusive. The District Court held that the plaintiff's bill stated a cause of action and denied, therefore, the motion of the receiver. The opinion of the court starts with the general rule that prior to receivership a stockholder in a national bank has a common-law right to inspect the books of the bank.[25] This right is dependent on the good faith of the stockholder and must be germane to his interest in the corporation. Apart from those qualifications, the right is unlimited while the bank is a going concern and the court must thus determine whether or not the right survived the receivership. Reviewing the prior cases dealing with business corporations and state banks, the court found that the right of inspection does not expire on receivership.

"As to corporations generally, a stockholder's right to examine the corporate books is not extinguished by receivership. The receiver has possession and custody of the books, but he has no better authority to bar access to them by stockholders than the corporate officers had before receivership. . . . Unless there is a solid distinction between the receivership of a national bank, the stockholder's right of examination in the latter case is not at the mercy of the receiver."[26]

The court then examined the provisions of the National Banking Act dealing with the appointment of a receiver by the Comptroller of the Currency.[27] After this examination, the court concluded:

"There is nothing in the statute or in the decisions interpretative of it that is destructive of the stockholder's right to examine the books of the closed bank or that vests the comptroller or the receiver with arbitrary powers to keep the books from the stockholders. The stockholders are still stockholders. They are entitled to any surplus that may remain after payment of debts. Because of such interest, they may under certain conditions bring suit in the bank's right against officers and directors who have wasted the assets, in cases where the receiver has refused to bring suit . . . The right to bring such suit would generally be barren if the comptroller or receiver could arbitrarily deprive a stockholder of an inspection of the books."[28]

Admitting then that there may be cases where the receiver may lawfully refuse the inspection of the corporate books and records by the shareholders, the court emphatically declared that in the present case the refusal of the defendant to permit inspection was wholly unjustified.

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[25] See Guthrie v. Harkness, 199 U. S. 148, 26 Sup. Ct. 4, 50 L. Ed. 130 (1905); Curtis v. Connly, 257 U. S. 260, 42 Sup. Ct. 100, 66 L. Ed. 222 (1921).

[26] 9 F. Supp. 465, 467 (1935).

[27] 12 U. S. C. A. §§ 191 *et seq.*

[28] 9 F. Supp. 465, 468 (1935).

"There may be instances where a stockholder's examination of the books would be disruptive of plans for reorganization then pending and would thus imperil the interests of creditors and other stockholders. There may be instances where there is no purpose other than curiosity to be served by permitting examination. Such cases may be dealt with when they come up. But where a stockholder makes grave charges of malfeasance against the officers and directors, with the receiver refusing to take action, and alleges facts tending to show that the interests of creditors and stockholders cannot be prejudiced by an examination of the books, no reason is apparent why he should not have the desired examination. It is not perceived how an examination in such a case can be said to impede or embarrass the prompt and effective winding up of the insolvent estate. A bill setting forth such facts makes a prima facie case for relief in court and is sufficient on its face."[29]

From the decree of the District Court enjoining him from interfering with the plaintiff's inspection of the books and records of the bank the receiver appealed. The Circuit Court of Appeals, however, dismissed the appeal and affirmed the decree of the court below.[30] Judge Augustus N. Hand, who delivered the opinion of the court, pointed out that a stockholder of a national bank in the hands of a receiver is not entitled to the inspection of the corporate books as a matter of right, but that the courts will decree such inspection if, as in the present case, the refusal of the receiver to permit such inspection seems to be inequitable.

"It is manifest that a stockholder of an insolvent national bank is vitally interested in the efficient liquidation of its assets, not only because of his possible right to share in a surplus after payment of the debts, but also because the amount of the assessment on his stock which the comptroller may levy will be directly affected by the success of the receiver in collecting outstanding claims. It is true that a liberal construction has always been placed upon the National Banking Act, so that the liquidation of insolvent banks can proceed without undue interruptions and to as prompt a conclusion as possible. But a recognition of the right of a stockholder to obtain an order for an examination of the books of a bank, in case where a fair reason for the examination is shown and where the examination is so conducted as not to inconvenience the receiver in his administration, preserves rights of stockholders that existed prior to the time when the comptroller took over the administration, is not in derogation of any statute, and affords a safeguard against careless administration and arbitrary conduct. It should only be granted where there is a showing of some justifiable reason; otherwise the comptroller might be unduly harassed in his administration."[31]

In reaching the result that the plaintiff should be given the opportunity to examine the corporate books in the hands of

[29] *Ibid.*

[30] Wittnebel v. Loughman, 80 F. (2d) 222 (C. C. A. 2d, 1935), *cert. den.* 297 U. S. 716, 56 Sup. Ct. 590, 80 L. Ed. 1001 (1936).

[31] *Id.*, at 223, 224.

the receiver, Judge Hand particularly stressed the fact that without such opportunity for inspection the plaintiff's right to bring a shareholder's bill for mismanagement by the president and the officers of the company would be without much practical value.

> "If the officers or the receiver fail to sue on demand, a stockholder has the right to bring a representative suit on behalf of the bank to redress wrongs which it has suffered . . . Such a right would be ineffective if the stockholder could not determine by an inspection whether there was a basis to sustain his cause of action. We can see no reason for so abridging the common-law right as to deprive a shareholder of the means of protecting his interest by an inspection so long as it may be had without undue interference with the administration of the receiver."[32]

Another federal case with bearing on our problem is *Finance Co. of America at Baltimore* v. *Brock*.[33] Plaintiffs in this case had brought an action at law in the Federal District Court for the Eastern District of Louisiana to recover damages from the directors and officers of the then defunct Canal Bank & Trust Company for alleged fraudulent misrepresentations by which the plaintiffs were induced to take stock in this company. The plaintiffs then brought a bill of discovery in the District Court in aid of their action at law against the liquidators of the Canal Bank & Trust Company, who had been appointed by the state court, for the presentation of numerous books and records of the company containing evidence material to the case. The liquidators of the company met the bill with a motion to dismiss for want of jurisdiction of the Federal court, claiming that the State court had exclusive juridiction over the liquidation. The District Court sustained this motion of the liquidators and dismissed the bill. On appeal, the Circuit Court of Appeals held that the dismissal by the court below for want of jurisdiction constituted error in law and remanded the case. The court held that in a proper case a Federal court can require discovery of state liquidators, but expressed no opinion on the question whether in the present case a bill of discovery could be successfully brought against the liquidators. Since the plaintiffs were stockholders of the defunct banking company, their proper mode of relief, in the opinion of the court, was a suit for inspection of the corporate books and records.

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[32] *Id.*, at 224.
[33] 80 F. (2d) 713 (C. C. A. 5th, 1936).

"But the complainants here are stockholders also of the defunct bank, and, while their right of examination of their own books may be somewhat limited by the possession of the liquidators, who are in a sense the officers of the state, the cases indicate that the liquidators, when guided by a court, should be liberal in permitting stockholders to inform themselves for their own protection."[34]

III. RIGHT OF INSPECTION IN CASE OF CORPORATE REORGANIZATION

Whereas the cases considered in the preceding section dealt with the shareholder's right of inspection in case of corporate liquidation, the following cases will present the problem whether the shareholders are entitled to examination of the corporate books and records in case of a corporate reorganization. The courts in these cases are frequently faced with the task of reconciling conflicting interests. On the one hand, there is the interest of the public and of a majority of the parties concerned in a speedy and effective enforcement of a given reorganization scheme, whereas, on the other hand, individual shareholders wish to use the device of a request for inspection of the corporate books to suggest or to inaugurate a different plan of reorganization, which seems to be more attractive to them. How the courts will weigh these conflicting equities and how solve this clash of opposite interests will appear from the following decisions.

The English case of *In re Glamorganshire Banking Company*,[35] deals with the right of inspection by a dissenting shareholder in case of a corporate reconstruction under the Companies Act of 1862. In this case, the majority of the shareholders resolved that it was desirable to reconstruct the company, and that, with a view thereto, the company be wound up voluntarily and that liquidators be appointed and authorized to consent to the registration of a new company. Subsequently to this resolution, one Mrs. Morgan, who belonged to the dissenting minority, asked the liquidators to purchase her stock interest in the company. When the liquidators offered to purchase her interest at the rate of 5s. in the pound, Mrs. Morgan declined

[34] 80 F. (2d) 713, 715 (1936). See also State *ex rel.* Burleigh v. Miller, 266 S. W. 985 (Supr. Ct. of Mo. 1924), where it was held that a receiver who had sued an alleged subscriber for stock in a corporation was not entitled to object to the latter's obtaining an order for inspection of the corporation's books.

[35] 28 Ch. D. 620 (1884).

the offer and asked that the price be settled by arbitration, in accordance with Section 161 of the Companies Act. Three months after this application for arbitration under the statute, Mrs. Morgan asked the liquidators to permit the books of the company to be inspected for the purpose of advising her whether the offer originally made by the liquidators was sufficient. The liquidators declined to produce the books for inspection, whereupon, Mrs. Morgan's attorney filed a bill asking the court to order the liquidators to produce the books of the company. After the bill had been filed, both parties appointed arbitrators in accordance with the provisions of the Companies Act. After a hearing, the court dismissed the bill for the production of the corporate books. Lord Bacon, delivering the opinion of the court, pointed out that it lies within the discretion of the court to permit shareholders to inspect the books of a company in the process of reconstruction, but that in the case at bar, the court will not make use of this discretion.

"If a case were presented to the Court in which fraud was suggested, or inaccuracy was at all pointed out, or even hinted at, the Court would have to exercise that discretion which is reposed in it and do its best to see that justice was being done between the parties. But in this case the facts agreed to are clear and plain. All that has been done has been done regularly. All the members of the old company except six have agreed to that which has been done."[36]

The court then emphasized that the books had been handed over to the possession of the new company and that the liquidators had, therefore, lost the custody of them. But the real basis of the decision is that the plaintiff had elected to invoke arbitration and had, therefore, no legal or equitable interest in the examination of the books of the company.

"The application dealing with this peculiar subject is different from that in the *Birmingham Bank Case*, and others, where the thing had come to an end, and where the secrecy clause was resorted to, and resorted to in vain. That is not so here. The current accounts which the customers had with the old bank are carried on into the new bank, and the applicant desires to look into those accounts and see what is their condition, not even by herself, because she cannot do it, but her solicitor or agent is to be let in to examine the circumstances of the several customers in the accounts before the transfer. The terms of the summons are open to no kind of limitation. They are to produce everything in the world relating to the assets of the company. There never was a case in which any such application was entertained by this Court. The Act of Parliament has with the utmost caution provided for the state of circumstances now before me. It has given to any dissentient shareholder who does not accept the proceedings

[36] 28 Ch. D. 625 (1884).

adopted by the majority of the shareholders the right to go to abritration. He goes to arbitration with all the powers contained in the Act of 1862, and with all the powers contained in the *Common Law Procedure Act*. What may be the result of the arbitration I cannot at the present moment anticipate, but there are means provided by the law to enable the applicant, who last April chose to go to arbitration, to go to that arbitration safely, and with the means of getting the fullest information she is entitled to. In my judgment, no reason has been suggested, nor has any word of proof or argument been adduced to lead me to believe that there is any necessity for that production which is asked for by this summons. Therefore I must dismiss it."[37]

The case just considered illustrates in an interesting way that the courts will deny the right of inspection if a shareholder instead of participating in the reorganization scheme wants to liquidate his interest in the company and his right of information is otherwise protected by statute. In such a case an inspection of the corporate books by the shareholder would unduly delay and hamper the process of reorganization. But, as indicated by the opinion, in proper cases the courts will grant to shareholders the right to inspect the books of a company which is undergoing reorganization, if the balance of equities is in their favor.

The leading American case on the subject is *Chable* v. *Nicaragua Canal Construction Co.*[38] In this case, a shareholder of a corporation in the process of reorganization, who had acquired his stock six months after the appointment of the receiver, asked the court for leave to inspect the company's books in the hands of the receiver. The receiver, who had refused the permission for inspection, defended on the ground that the petition, if successful, might endanger a plan for reorganization approved by the majority of the shareholders, which provided for an early liquidation of the debts of the company.

The court, before going into the merits of the case at bar, attempted to lay down certain general rules determining the shareholders' right of examination in cases of receivership and corporate reorganization. Although the language of the court on this point is merely *dictum*, its full citation seems to be warranted, since most of the later cases are relying on it:

"When a corporation has suffered financial shipwreck, and its property and assets, including its books, come into the possession of the court and the custody of the court's officer, the receiver, the question whether or not an inspection of those books shall be accorded to a stockholder in the shipwrecked concern is one resting in the discre-

[37] *Id.*, at 626, 627.
[38] 59 Fed. 846 (C. C. S. D. N. Y. 1894).

tion of the court, unhampered by any decisions touching such right of inspection while the corporation was still a going concern in the hands of its officers and directors. Ordinarily it would seem that such discretion should be exercised by the court most liberally towards every individual stockholder who shows some reason other than mere idle curiosity which induces him to ask for the inspection. It is no doubt a fact that in many cases the information derived and the conclusions arrived at upon such inspection may promote differences of opinion, controversies, and animosities between members of the corporation, and to that extent be an interruption to the conduct of its affairs, but that is one of the misfortunes attendant upon financial shipwreck. The right of the individual stockholder to obtain from the court an inspection of its books in the court's custody, in order to inform himself as to past transactions and present conditions, or to enable him to determine what may be most conducive to the protection of his own interests as a stockholder in the future, is one entitled to the favorable consideration of a court of equity.

"The theory of a receivership such as this is that the court takes possession of the assets of the corporation with the intention of distributing them equitably among all entitled to receive, without exposing creditors and stockholders alike to the heavy sacrifices which would be likely to occur should the property as an entirety be broken up, and sold, bit by bit, as the result of a ruinous race of diligence between creditors. Having the securities in its possession, the court retains them until they can be properly marshalled, the claims of all ascertained, the property converted into money, and the same distributed equitably according to the rights of all parties. Frequently, before this termination of the proceeding is reached, some plan of reorganization, satisfactory to nearly all interested, and abundantly protecting the full legal and equitable rights of those not entering into it, is perfected, and the receivership terminates by a sale of the property to some new corporation, or to some committee, organized under such a plan. A stockholder who in good faith asks for an examination of the books in the custody of the court, in order to enable him to determine whether or not such a proposed plan of reorganization is or is not a desirable one for himself and the other stockholders to enter into, should be accorded such inspection, under proper regulations as to time and circumstance, so as not to interfere either with the transaction of the receiver's duties or with such inspection as his fellow members may be entitled to."[39]

The court, after having thus expressed that in reorganization cases the courts should be most liberal in granting the right of inspection to dissenting shareholders, undertook to consider the specific objections raised by the receiver against the present petition. With regard to the objection that the object of the application was to obtain material to be used in convincing other stockholders that a proposed plan of reorganization should not be carried out and that the application was primarily intended to interfere with the accomplishment of a plan which met the approval of a majority of the stockholders, who had been

[39] 59 Fed. 846, 847 (1894).

content to accept it without such information as here asked for, the court said:

"This objection, however, is not a sufficient answer to the application. The fact that a majority of the persons interested are satisfied thus to accept it is no reason why a stockholder who wishes for further information, to which he is entitled, should be refused it, even though, when it is once obtained, he intends to present it to his fellow stockholders as an argument to dissuade them from accepting the plan. If the plan is one which commends itself to those interested, his arguments will probably have little weight with them."[40]

The further objection of the receiver that the petition tended to defeat a reorganization scheme which seemed to be very satisfactory and promising was met by the court in the following words:

"The receiver himself appears by counsel before the court, asking that he be instructed to refuse permission, on the ground that the proposed plan is one which promises to afford means for an early liquidation of the debts of the company, and the renewal of the work of construction; that he has uniformly commended the scheme of reorganization already proposed, and that the apparent object of the petitioner and his associates is to defeat such plan. So far as he has heretofore refused to allow inspection of the books by the stockholders, his course is entirely approved. In every case of doubt it is well for a receiver to refrain from action until he may obtain the instruction of the court, whose officer he is. It is not, however, the duty of a receiver to formulate or to promote one or other proposed plan of reorganization. Whether there shall be a new organization formed of stockholders, bondholders, or creditors, with what respective interests, and upon what terms, is one that should be left for the determination of the persons interested, without interference in any way by the court or its officers. The court in these cases is a harbor of refuge, not a repair shop."[41]

The court concluded its inquiry into the shareholders' right to inspect the books of a company undergoing reorganization with the statement that it had felt bound to discuss the merits of the petition since, as stated on the argument of the case, some sixty or more stockholders were asking for an inspection. However, the court denied relief to the present petitioner because it appeared that he did not become a stockholder until six months after the appointment of the receiver.

"It is manifest that this situation is very different from that of one who was a stockholder of record at the time of the catastrophe which wrecked the corporation. Such a stockholder, the value of whose

[40] *Id.*, at 847.

[41] *Id.*, at 847, 848. In so far as the opinion seems to indicate that the fairness of the reorganization plan is no matter of the court's concern, this part of the opinion may be considered as overruled by the decision of the Supreme Court in the *Boyd* case. See Northern Pacific Railway Company v. Boyd, 228 U. S. 482, 33 Sup. Ct. 554, 57 L. Ed. 931 (1913).

property has been affected by the manner in which the business of the corporation has been conducted, is entitled to a different measure of consideration from that shown to a mere speculator, who, after the property has passed to the receiver, buys an interest in what may be saved out of the wreck."[42]

The principles of the *Chable* case, *supra,* have found application in the recent Maryland case of *Newcomer* v. *Miller.*[43] Although this case does not concern a corporate reorganization in a technical sense, the case furnishes close analogies to strict reorganization cases. In this case, one Miller and his wife were the sole stockholders in a family corporation. Miller, who was also president of the corporation, pledged all of the stock in the company to some of his creditors in order to secure an indebtedness of $1,500,000. On June 29, 1933, a bill in equity was filed in the name of Mrs. Miller, alleging that the corporation was indebted to her and praying for the appointment of receivers for the company. Miller consented to the receivership and he and his wife's attorney were appointed receivers. On July 26, 1933, the foreclosure and sale of the collateral occurred, and the pledgees then became the owners of all the stock. On August 10, 1933, the receivers reported to the court a contract with Mrs. Miller, subject to the approval of the court, to purchase all the assets of the corporation. On September 25, no exceptions having been filed, the sale was finally ratified by the court. On the same day the new owners of the stock wrote a letter to the receivers requiring permission to examine the books of the company, but received no answer. On November 7, they filed a petition asking for an order of the court permitting them examination of the books. In this petition they questioned the validity of the debts claimed by Mrs. Miller, and complained of the whole proceeding as a maneuver of their debtor to hinder recovery on his debts, and to retain the property for his own benefit. The court dismissed the petition, but, on appeal, the Court of Appeals reversed the order of the lower court. In an elaborate opinion the court held the petitioners to be entitled to examine the corporation's books in the hands of the receivers:

"The application here is not one for the production of books and papers by an adversary owner or possessor of them. However the receivers may stand in personal opposition to the applicants, they are, as receivers, entirely neutral custodians, and are to be treated as

[42] 59 Fed. 846, 848 (1894).
[43] 166 Md. 675, 172 Atl. 242, 92 A. L. R. 1043 (1934).

such. More accurately, the court itself is the custodian; the receivers holding for the court. . . . And the holding is not only for the direct use of the court and its receivers in the administration of the receivership, but also for the use and benefit of all parties in interest, including the applicants. . . . The applicants have had from the beginning an interest in the assets as pledgees and owners of the stock, conveyed to them as a means of repayment of large loans, and their interest is involved in a proceeding conducted by representatives of the pledgors, with the anticipated result of leaving the security good for nothing. They are, in fact, as the owners of the stock of the corporation, the only parties now having the ultimate legal interest in the books. They question the good faith of the receivership proceeding, charging fraud in it. There are no allegations of specific wrong to the rights of the applicants, and the purpose seems rather to be to subject to inquiry a proceeding in which their interests are affected, but in which they cannot now protect their rights or even know what they may be, and are left dependent upon the care of their adversaries in interest. For fraud they might, of course, attack and reopen the proceeding so far as the fraud might have affected it. In this situation and for these purposes they must, in the opinion of this court, be given access to any information the books may contain. Whatever assurance the court might derive from the character of the receivers and its own supervision of their receivership relegating the interests of the appellants to the initiative and fairness of their opponents in interest would not be a just arrangement. Inspection of the books may turn out to be without usefulness to the appellants, but the situation requires that they be given facilities for attending to their own interests, and the court should not be astute to anticipate lack of advantage for them in what they ask, especially when the relief is so easy."[44]

IV. RIGHT OF INSPECTION IN CASE OF CORPORATE REORGANIZATION UNDER SECTION 77B OF THE BANKRUPTCY ACT

The foregoing discussion has shown that the right of inspection exists during receivership proceedings. The problem with

[44] 166 Md. 675, 679 (1934). With regard to the argument of the receivers that the denial of the right of inspection by the lower court was within the discretion of the court and, therefore, not subject to review by the appellate tribunal, the Court of Appeals said: "The few references in the authorities which support this argument have had to deal only with applications by holders of minor portions of the stock. . . . But applications even by owners of all the stock might be opposed by considerations of convenience, and of justice to creditors, in weighing which the court might be allowed discretion. The existence of a discretion does not in all cases prevent review, in others discretion is reviewable. . . . The extent of discretion and the right of review differ according to the purpose of the discretion. Here the court is considering, not a mere regulation of order and progress in a proceeding in court, or in a matter in which the judge's close contact with the circumstances would give him an understanding preferable to that of judges on appeal, so that by reason of these or other circumstances it should defer to the judgment of the trial judge. It is considering an action which might have a much closer connection with essential justice. Exclusion from access to information might amount to exclusion of rights from a hearing, and it does not seem permissible to deny review on complaints of substantial wrong, as here." (*Id.*, 680, 681.)

which we have to deal now is whether the right to inspect corporate books will survive reorganization proceedings under Section 77B of the Bankruptcy Act.

The Bankruptcy Act itself is silent on this question. The only reference to the general problem is contained in subsection (c), clause (4) of the Section 77B, where it is provided that the judge in addition to the jurisdiction and powers elsewhere in this section conferred upon him "may direct the debtor, or the trustee or trustees if appointed, to prepare (a) a list of all known bondholders and creditors of, or claimants against, the debtor or its property, and the amounts and character of their debts, claims, and securities, and the last known post-office address or place of business of each creditor or claimant, and (b) a list of stockholders of each class of the debtor, with the last known post-office address or place of business of each, which lists shall be open to the inspection of any creditor or stockholder of the debtor, during reasonable business hours, upon application to the debtor, or to the trustee or trustees, if appointed, and the contents of such lists shall not constitute admissions by the debtor or the trustees in a proceeding under this section or otherwise."

The question raised by these provisions is whether Congress through their adoption wanted to abridge the stockholders' common-law right of inspection or whether these provisions were intended as additional sources of relief for persons desiring information about the state of the affairs of a corporation in a proceeding under Section 77B of the Bankruptcy Act. A different answer has been given to this question by two federal courts which had occasion to consider the problem.

The District Court for the Eastern District of New York in *In re Bush Terminal Co.*,[45] held that the right of inspection is not available to the stockholders of a corporation which is undergoing reorganization under Section 77B. In this case, the corporation, which had previously been placed in equity receivership, had its petition for reorganization under Section 77B approved by the District Court. Receivers who had served in the receivership proceedings were designated as trustees of the debtor. The petitioner was the founder of the corporation, its president, director and controlling stockholder. After the

[45] 11 F. Supp. 387 (E. D. N. Y. 1935).

debtor's petition was approved, petitioner filed a plan of reorganization; his previously proposed plan having been rejected by the debtor's board of directors. Desiring to call a meeting of the stockholders for the purpose of electing a new board of directors the petitioner applied to the District Court for an order to direct the trustees to permit him to inspect the debtor's stock book and obtain therefrom a list of stockholders. The District Court, however, denied the application on the apparent ground that the stockholder's right of inspection which he claimed both under the common law and the statute of New York[46] has been limited by Section 77B of the Bankruptcy Act.

"State statutes must yield to the bankruptcy law, as amended (11 USCA) and do not give a remedy where the bankruptcy court determines that such remedy interferes with the proper efforts of this court to rehabilitate the debtor rather than liquidate it. The title to all the assets of the debtor is in these trustees, and this court has exclusive jurisdiction over same. Moreover, certain tentative plans, in accordance with section 77B, have already been submitted and referred to a special master. The whole purpose of this court, therefore, is now directed towards a possible rehabilitation of this debtor within a reasonable time. . . . Section 77B however does, it seems to me, contemplate that, if a creditor or stockholder desires, for instance, to get in touch with those of his own class for the purpose of presenting a plan or opposing a plan, and a proper application is made by way of a committee or otherwise for this purpose or for some other purpose fairly shown to be helpful to the rehabilitation of the debtor and within due safeguards laid down, then, on the presentation of such application, on due notice to the trustees, such information may be available by proper direction of the judge pursuant to (c) (4) (b) of the act, 11 USCA §207 (c) (4) (b)."[47]

The District Court also emphasized that the petitioner could not possibly desire a stockholders' meeting to present a plan of reorganization, since he had already proposed a plan and that the present application would certainly tend to obstruct the reorganization of the debtor corporation.

"It serves no purpose to now have injected into this proceeding stockholders' fights, efforts to control the debtor, criticism of management, etc., all of which, while occasionally present in ordinary corporate management, have no place when the court, having sole charge over the debtor, is seeking to reorganize it under section 77B, 11 USCA §207. The applicant does not desire to obtain a list of the stockholders for the purpose of presenting a plan, for, as I have said, two tentative plans, one of them by him, are already before the special master, and before that official all discussions and suggestions of other plans or modifications should and must take place. All creditors and stockholders must have notice of these hearings and

[46] N. Y. Stock Corporation Law, § 10 (Consol. Laws N. Y. c. 59). See People *ex rel.* Lorge v. Consolidated Nat. Bank, 105 App. Div. 409, 94 N. Y. Supp. 173 (1905).

[47] 11 F. Supp. 387, 388 (1935).

of all important steps in this proceeding. Moreover, the trustees are not presenting any plan, for that is the duty of creditors or debtor. While the trustees are continuing the business of the debtor, and while, both as receivers and now as trustees, it appears to the court that they have rendered excellent and skillful service in this regard, nevertheless, the debtor is in an entirely different position in regard to stock transfers, etc., from what it would be had not these receiverships and bankruptcy proceedings intervened. Consequently, nothing will be gained by a meeting of stockholders, at this time, to elect new directors and possibly to thus interfere with the present management of the business by these trustees, through the present board, which seems to be functioning in co-operation with the trustees, pending the acceptance or rejection of a plan. The extraordinary power of this court granted by Congress pursuant to section 77B, while it should be cautiously and intelligently exercised, seems to me to extend to such supervision over the calling of such meetings or other acts of the debtor which would appear to the court to be opposed to, or which may reasonably tend to obstruct, a speedy reorganization of the debtor."[48]

From the order of the District Court denying the application petitioner appealed to the Circuit Court of Appeals. Thereupon, in *In re Bush Terminal Co.*,[49] the Circuit Court declared that the lower court erred in refusing the right to inspect and, accordingly, reversed the order of the District Court. Judge Manton, who delivered the opinion of the court, pointed out that the right of inspection is not affected by proceedings under Section 77B of the Bankruptcy Act, and that the reorganization court may grant leave to inspect the corporate books, whenever a proper case arises for inspection.

"While it was possible for Congress to limit, for proper reason, this right to examine the books, it has not done so. The court below believed that section 77B, sub-sec. (c) (4), 11 U. S. C. A., § 207 (c) (4), did limit the stockholders' right of inspection. While this provision might be considered as merely giving a stockholder the right in addition to that which was his under the state statute and the common law, such would be a strained interpretation of the subdivision of the act. The natural and obvious meaning is that the statute gives the judge the power to deny the right to inspect upon circumstances which call forth the exercise of such discretionary refusal. The use of the word "may" indicates that the judge is given the power, but not the absolute duty, to permit inspection, and though that power would be ordinarily exercised, it seems to be contemplated by the statute that the judge may refuse to exercise it where its exertion would, for one reason or another, be detrimental or harmful to the process of reorganization. Such is not the case here. The district judge erred in denying the appellant's application for inspection, for no ground was shown for the exercise of such power. Appellant was a large stockholder of the debtor. He was the dominating influence as regards the action of a great number of other stockholders. He desired a list of the stockholders so as to call a meeting of them and elect a new board of directors. It was the

[48] *Ibid.*
[49] 78 F. (2d) 662 (C. C. A. 2d, 1935).

opinion of the District Court that a meeting to elect new directors would possibly interfere with appellees' management of the business, and reasonably tend to obstruct a reorganization of the debtor. But, as here contended by the appellant, to refuse the stockholders free action in the matter of voting for directors may cause the stockholders to be represented by directors who did not truly represent them, and the stockholders are the real parties in interest. . . . It would seem proper for the purposes of section 77B, 11 U. S. C. A., §207, and the protection of the stockholders' rights, that there be unrestricted communication between the stockholders. The court should not so restrict, by declining inspection of the list of stockholders, this freedom of action. The stockholders ought to be free to communicate with each other and express their opinions as to terms and conditions as to all matters pertaining to the interests of themselves as stockholders. By section 77B, sub-sec. (c), (11), 11 U. S. C. A., §207 (c) (11), the debtor is given the right to be heard on all questions. Obviously, the stockholders should have the right to be adequately represented in the conduct of the debtor's affairs, especially in such an important matter as the reorganization of the debtor. Such representation can be obtained only by having as directors persons of their choice. By sub-section (d), 11 U. S. C. A., §207 (d), the debtor is given the power to propose a plan of reorganization. No reason is advanced why stockholders, if they feel that the present board of directors is not acting in their interest, or has caused an unsatisfactory plan to be filed on behalf of the debtor, should not cause a new board to be elected which will act in conformance with the stockholders' wishes. The court below expressed the opinion that should a new board of directors file a plan on behalf of the debtor and it conflicts with the one previously filed, confusion might arise. No fanciful 'endless confusion', as stated below, should deprive stockholders of the right to be adequately represented by directors of their own selection. That appellant seeks to control the debtor is of no concern if he is in a position to obtain control. He obtained the right to such control by having control of more than a majority of the stock."[80]

[80] 78 F. (2d) 662, 664 (1935). With regard to the appellant's right of procuring a stockholders' meeting for the purpose of electing a new board of directors, the Circuit Court went on to say: "A court of equity or bankruptcy may enjoin any action which would tend to defeat or impair its jurisdiction. See Continental Illinois National Bank and Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 55 S. Ct. 595, 79 L. Ed. 1110; Section 2 (15) of the Bankruptcy Act, 11 U. S. C. A., § 11 (15). This power in the court is extraordinary and should be exercised only where the harm, likely to flow from the stockholders' action, is more real than here, and disproportionate to the good obtainable. The corporation can act only through its board of directors selected by its stockholders. Regard for this has been had by the legislation resulting in section 77B, 11 U. S. C. A., § 207. The board of directors of the corporation, having the right to submit a plan or participate in a reorganization plan, must necessarily have freedom of action for its consideration. If the right of stockholders to elect a board of directors should not be carefully guarded and protected, the statute giving the debtor a right to be heard or to propose a plan of reorganization could not truly be exercised, for the board of directors is the representative of the stockholders." (*Id.*, 665.) The court distinguished the case at bar from the case of Graselli Chemical Co. v. Ætna Explosives Co., 252 Fed. 456 (1918), which granted an injunction staying a stockholders' meeting when the corporation was in receivership on the ground that such a meeting would interfere unduly with the reorganization plans. The court pointed out that in the Graselli

As the law now stands, under the ruling of the Second Circuit in the *Bush Terminal* case, the stockholders' right of inspection survives reorganization proceedings under Section 77B of the Bankruptcy Act. However, like in the receivership cases discussed previously, this right does not survive as an absolute right of the stockholders, but as right which may be enforced or denied at the discretion of the court. As a general rule, the courts will be liberal in granting the right of inspection and insist that impediment in rapidity of reorganization be subservient to the protection of the stockholders' rights under Section 77B. On the other hand, the reorganization courts will refuse to permit inspection, if such permission would be detrimental or harmful to the process of reorganization. Just what intended acts or purposes of an applicant will justify a court in refusing permission to inspect has to be left to the courts' rulings in future litigations.

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case the receivers had made a good profit and could have paid off the preferred stockholders of the corporation and would pay them off in the near future, the preferred stockholders having been paid all past dividends. As their right to vote was limited to the question of mortgaging property of the corporation except where their dividends had not been paid for over eight months, permitting an election at that time would have given preferred stockholders control of the corporation when they would soon after be paid off and have no voice in the management of the corporation, and so be inequitable to the rights of the common holders. For the importance which the courts have attached to a truly representative board for the corporation under section 77B, see also *In re* Kelly-Springfield Tire Co., 10 F. Supp. 414 (D. Md. 1935).